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No. 613

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

THE DANFORTH FOUNDATION,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Petitioner prays that this Court issue its writ of certiorari to the United States Court of Appeals for the Eighth Circuit to review the judgment entered in the above case on June 30, 1965.

Opinions Below.

The opinion of the United States District Court for the Eastern District of Missouri is reported at 222 F. Supp. 761. (Appendix A.) The opinion of the United States Court of Appeals for the Eighth Circuit, affirming the District Court, is reported at 347 F.2d 673. (Appendix B.)

Jurisdiction.

The judgment of the Court of Appeals for the Eighth Circuit was made and entered on June 30, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

Question Presented.

Did the Court of Appeals correctly interpret and apply Section 3814 of the Internal Revenue Code of 1939 [now Section 504 of the Code of 1954] when it sustained the revocation of the Danforth Foundation's charitable foundation income tax exemption for the years 1951 and 1952?

The Statutes And Regulation Involved.

The principal statute involved in this case is Section 3814(1) of the Internal Revenue Code of 1939,* which became effective January 1, 1951, and which provides, as here pertinent:

> "In the case of any organization described in Section 101(6) to which Section 3813 is applicable, if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year—
>
> "(1) are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under Section 101(6); . . . exemption under Section 101(6) shall be denied for the taxable year."

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* This Section has, with minor revisions, become Section 504 of the Internal Revenue Code of 1954.

Section 101, Internal Revenue Code of 1939, provides, as here pertinent:

> "... [T]he following organizations shall be exempt from taxation under this chapter—
>
> * * *
>
> (6) Corporations, and any community chest, fund or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation. For loss of exemption under certain circumstances, see 3813 and 3814;"
>
> * * *

Also relevant to the issue here presented is Treasury Regulation 111, § 29.3814(1) as amended, which states, *inter alia*:

> "Amounts accumulated out of income become unreasonable when more income is accumulated than is needed, or when the duration of the accumulation is longer than is needed, in order to carry out the purpose constituting the basis for the organization's exemption."

STATEMENT OF THE CASE.

In 1939 the Commissioner of Internal Revenue determined that the Danforth Foundation (hereinafter the Foundation) was exempt from income tax under § 101(6), Internal Revenue Code of 1939, "so long as there is no change in your organization, your purposes or your method of operation." (R. 44, Stip. Ex. 5.) In 1958 the Commissioner ruled that the Foundation had unreasonably accumulated income during 1951 and 1952 and revoked its tax

exemption for those years under the provisions of § 3814(1), Internal Revenue Code of 1939. The Commissioner's revocation specifically excluded 1953 and subsequent years. (R. 44-45.)

The Foundation paid the following income tax, interest and penalties:

		Sec. 291(a)	
Year	*Tax*	*Penalty*	*Interest*
1951	$187,785.79	$46,946.45	$94,542.00
1952	$134,952.31	$33,738.08	$59,844.88

and then brought the instant action in the United States District Court for the Eastern District of Missouri under 28 U.S.C. § 1346(a)(1) to recover those amounts. The District Court held that the Commissioner had properly revoked the Foundation's exemption under § 3814(1).* The Foundation appealed to the United States Court of Appeals for the Eighth Circuit, which affirmed.

The Foundation was incorporated under the laws of the State of Missouri in 1927 as a perpetual charitable foundation "solely and only for purely charitable, educational and religious purposes and to promote the well being of mankind throughout the United States." (R. 42-43.)

William H. Danforth and members of his family were the trustees of the Foundation from its creation until the taxable years in question. (R. 51.) Danforth was President of the Ralston Purina Company until 1932 and thereafter Chairman of its Board. His son, Donald, succeeded him as President of Ralston. (R. 101.) Virtually all of the gifts to the Foundation have come from the Danforth family and most have been in the form of shares of the common stock of Ralston. (Stip. Ex. 12.)

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* The penalty issue was settled.

The Foundation grew rather slowly during the first 10 years of its existence. In 1938, the market value of its assets was $1,836,191. (Stip. Ex. 14.) By the end of 1950 this value had risen to $24,138,717. (Stip. Ex. 26.) Most of the increase was due to the rise in the value of the Ralston shares. (Stip. Ex. 12, 14-26, 37.) The Foundation's failure to spend much of its income during this period also contributed to its increased wealth. Thus, by the end of 1950 its accumulated income, less capital gains, was $4,311,689. (Stip. Ex. 37.)

It was the intention of the Foundation's founders and its trustees to develop programs in the educational field which would be operated by the Foundation itself, and which would place special emphasis on moral, spiritual and religious values. (R. 52.) Some programs began before 1940, but not many. After 1940, money for the desired self-operating programs became available but the Foundation lacked the full-time executive leadership necessary to turn ideas into realities.

In 1945, the Foundation trustees decided to employ a full-time executive director. (R. 58, 113, 315.) They concluded that there was only one man who could adequately fill this post—Dr. Kenneth I. Brown, the President of Denison University. (R. 58, 135.) In 1949, after four years of negotiations Dr. Brown agreed to accept the position. He postponed the assumption of his duties until January 1, 1951. (R. 224.) During the five years between the trustee's decision to hire an executive director and the assumption by Dr. Brown of his duties, the Foundation accomplished little in terms of planning programs for the future.

The arrival of Dr. Brown on January 1, 1951, coincided with the effective date of Section 3814. He brought an end to the Foundation's failures to expend income—but not immediately. Dr. Brown needed time to formulate programs which would use this income in accord with Foundation's purposes.

For the years 1951 and 1952, the Foundation's gross income, less capital gains, was $1,290,241 and $1,221,295 respectively. Its total expenditures for 1951 amounted to $128,284, and for 1952, $176,131. At the end of 1952 its accumulated income was $6,934,739. (Stip. Ex. 37.)

The District Court found, and the Court of Appeals agreed, that the decisions to accumulate income during the early years of Dr. Brown's directorship, 1951 and 1952, were made in good faith and in anticipation of the early formulation of expansive programs which would more than use the accumulated funds. (Court of Appeals Opinion, 347 F.2d at 676-677; App. 21.) The contemplated planning did take place. During 1951 and 1952, three new programs actually materialized. The largest of these was the Danforth Graduate Fellows Program which involved the recruiting and training of college teachers who had special concern for the moral and spiritual needs of their students. (R. 69-70, 231-234.) These programs were not alone enough to make adequate use of the Foundation's income, but by October, 1952, Dr. Brown was able to develop ideas for other expenditures. At that time he outlined 12 additional activities "worthy of careful study." Almost all of these were adopted in the years that followed. (Pltf's Ex. 10.) Many were of a nature similar to the programs already undertaken by the Foundation, although some of them, in operation, took the forms of direct grants to other educa-

tional and religious outlets. While these programs were no more than ideas in 1952, they show the extent of the Foundation's planning activities during the taxable years in question. In 1953 and thereafter, the Commissioner found the expenditures of the Foundation to be sufficient to avoid the revocation provisions of § 3814. The planning done in 1951 and 1952 was successful.*

Both the District Court and the Court of Appeals limited their decisions to the holding that the Foundation had unreasonably accumulated income during 1951 and 1952. There was no issue as to misuse of Foundation funds or the use of funds for other than charitable purposes. The Court of Appeals stated (347 F.2d at 676-677; App. 21):

> "There can be no question upon the record before us as to the utmost good faith and the humanitarian and charitable purposes of William H. Danforth, creator of the trust, and William H. Danforth, his son Donald Danforth, and his daughter Dorothy Compton, who were serving as trustees of the Foundation during the period here in controversy."

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* Charitable expenditures between 1953 and 1960 totaled approximately $17,800,000 as compared with approximately $16,800,000 in income during that period. (Stip. Ex. 37)

REASONS FOR GRANTING THE WRIT.

The Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court. Rule 19(1)(b), Rules of the Supreme Court of the United States. Specifically, the Court of Appeals misinterpreted § 3814(1), Internal Revenue Code of 1939, in such a manner as to violate the language and intent of that statute. This misinterpretation works not only to the prejudice of the Danforth Foundation, but to all charitable organizations similarly situated.

The decision of the Court of Appeals, in effect, prohibits accumulations of income while a charitable foundation is in the process of formulating plans for future expenditures, without a determination of whether such an accumulation is reasonable. On page 11 of its opinion, the Court of Appeals states:

> "It would defeat the language and intent of § 3814, which was designed to force the use of foundation income for charitable purposes, to permit the delay in distribution of accumulating income which would result from withholding disbursement of such income until adequate self-operating programs were established which would consume the income as it accumulated. . . ."

This statement ignores the "language and intent of § 3814" which denies tax exemption only to those organizations with "unreasonable" accumulations of income.

The Court of Appeals' holding is a direct result of the substitution of its own test for the statutory criterion of reasonableness. The test applied by the Court of Appeals was that originally set forth in *Samuel Friedland Founda-*

tion v. *United States,* 144 F. Supp. 174, 92 (D. N.J. 1956) and adopted in *Erie Endowment* v. *United States,* 316 F.2d 151 (3d Cir. 1963) and *Stevens Bros. Foundation, Inc.* v. *Commissioner,* 324 F.2d 633 (8th Cir. 1963), *cert. denied,* 376 U.S. 969:

> "Does the charitable organization have a concrete program for the accumulation of income which will be devoted to a charitable purpose and in the light of existing circumstances is the program a reasonable one?"

While this test may be valuable in determining reasonableness in some cases, it cannot cover all circumstances. It completely excludes the situation where the charitable organization needs time to formulate a concrete program because of circumstances entirely unrelated to the effect of § 3814. Such an accumulation may be reasonable within the meaning of the statute and yet not come within the Court of Appeals' test.

The Court of Appeals also relied upon Treasury Regulation 111, § 29.3814-1 which states:

> "Amounts accumulated out of income become unreasonable when more income is accumulated than is needed, or when the duration of the accumulation is longer than is needed, in order to carry out the purpose constituting the basis for the organization's exemption."

The court obviously read the "concrete program" test into this regulation. However, it should be clear that what is "needed" by one charitable organization may be entirely different than what is "needed" by another. If this regulation implies that inflexible criteria are to be read into § 3814, the regulation is not compatible with the statute and should not be followed.

The facts of the instant case illustrate the impropriety of the "concrete program" test as a rule of law. The Court of Appeals notes that, by 1951, the Foundation was well-established and that the problem of a large excess of income over charitable expenditures was not a new one. (347 F.2d at 678; App. 25.) This analysis overlooks the fact that, prior to 1951, the Foundation did not adequately plan for future expenditures. Full scale planning did not take place until the taxable years in question. The statute took effect coincidentally with this new activity. To penalize the Foundation for indecision which occurred prior to the effective date of § 3814 would give that statute a retroactive effect not suggested in its language. While § 3814 takes into consideration the duration of accumulations, it does not contemplate that the decision to accumulate in prior years be reviewed. The only relevant consideration is the organization's failure to expend the accumulation and current income in the taxable year. The Court of Appeals failed to recognize this distinction.

The decision of the Court of Appeals in the instant case, in denying to a charitable organization such as the Danforth Foundation the opportunity to plan programs for expenditure, allows the Commissioner of Internal Revenue to determine how charitable funds should be spent. It is important that this Court determine whether this result was the one intended by Congress. At the very least, this Court should approve or disapprove the test applied by the Court of Appeals and examine that court's retroactive application of the statute.

CONCLUSION.

For the reasons stated above, a writ of certiorari to the United States Court of Appeals for the Eighth Circuit should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

THE DANFORTH FOUNDATION,
Plaintiff,
vs.
UNITED STATES OF AMERICA,
Defendant.
No. 61 C 123 (3)

MEMORANDUM OPINION
(Filed June 27, 1963)

Plaintiff brought this action to recover Federal income taxes claimed to be erroneously assessed and collected by the Commissioner for the years 1951 and 1952, with interest thereon and penalties.[1] This Court has jurisdiction under Title 28 U.S.C. Section 1346.

The pleadings in this case presented three issues: (1) Whether the Foundations tax-exempt status was properly denied for the taxable years 1951 and 1952 under the provisions of Section 3814 (1) of the Internal Revenue Code of 1939; (2) if so, is the Commissioner's determination of deductible expenditures correct; and (3) if exempt status was properly denied, is plaintiff subject to a penalty for failure to timely file returns for the years 1951 and 1952? Issue number (2) has been conceded by plaintiff and trial of issue (3) was reserved to a later date by

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[1] Plaintiff's claims for refund are as follows:

Year	Tax	Section 291 (a) Penalty	Interest
1951	$187,785.79	$46,946.45	$94,542.00
1952	134,952.31	33,738.08	59,844.88

pre-trial order. Issue (1) is the sole question now presented to the Court. The matter was tried to the Court and submitted on a partial stipulation of facts, transcript, exhibits and briefs.

The Danforth Foundation, hereinafter referred to as "the Foundation", was incorporated in 1927 by a pro forma decree of the Circuit Court of the City of St. Louis, Missouri, under the provisions of the Missouri law for chartering charitable organizations, Article XI, Chapter 90, Revised Statutes of Missouri, 1919. The purpose of the Foundation was originally set out as follows:

> This Foundation is formed solely and only for charitable and humanitarian purposes and to promote the well-being of mankind throughout the United States.

In 1933, the article was amended to read as follows:

> This Foundation is formed solely and only for purely charitable, educational and religious purposes and to promote the well-being of mankind throughout the United States."

The Articles of Agreement were amended in 1945 to make the existence of the Foundation perpetual.

The founders of the Foundation were William Danforth, president of Ralston Purina Company until 1936 and thereafter chairman of the board, and his wife, Adda Danforth. Mr. and Mrs. Danforth were the principal contributors to the assets of the Foundation throughout the period from its origin through the years here involved, the total value of their gifts being $4,864,657.00. The greater part of the assets of the Foundation after 1936 was comprised of common stock of the Ralston Purina Company, which stock was voted by proxy held during 1951 and 1952 by Donald

Danforth who succeeded his father as president of the Company. Three family members, William and Donald Danforth and Dorothy Compton, daughter of the founders, were trustees of the Foundation during the taxable years involved in this case.

The Commissioner, by letter dated April 13, 1939, determined that the Foundation was tax exempt under the provisions of Section 101(6), Chapter 1, of the Internal Revenue Code of 1939, for the year 1939 and subsequent years so long as there is no change in your organization, your purposes or your method of operation".

Section 3814, enacted effective September 23, 1950, provided for the denial of exemption under Section 101(6) in event of unreasonable accumulations of income. The statute was applicable to years beginning after December 31, 1950.

The Foundation filed for taxable years 1951 and 1952, as in other years, returns entitled "Return of Organization Exempt under Section 101(6)". By letter of July 21, 1958, the Commissioner ruled denying the Foundation's exemption for the years 1951 and 1952 because of accumulations of income held to be unreasonable within the meaning of Section 3814. Assessment pursuant to the proposed deficiencies in tax and penalties set out in a 30-day letter was consented to by the Foundation and the Foundation paid in full said assessment. The Foundation's claims for refund of the full amount paid together with interest were disallowed by the Commissioner.

The pertinent part of Section 3814 reads as follows:

> "In the case of any organization described in Section 101(6) to which Section 3813 is applicable, if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year —

> (1) are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under Section 101(6); . . . exemption under Section 101(6) shall be denied for the taxable year. Sept. 1950 64 Stat. 957."

The regulations merely rearrange the order of the words of the statute. Treasury Regulations 111, Sec. 29.3814-1 and 118 Sec. 39.3814-1. The legislative history of the Section is but a little more enlightening. The Revenue Act of 1950 was directed in part toward eliminating abuses of exempt status under Section 101(6). There was, prior to the enactment of the 1950 Act, frequent misuse of trust funds for the purpose of financing business interests of the grantor.[2] The House Bill provided not only against the application of funds to purposes other than the charitable purpose defined by the trust-forming instrument, but also provided for protection against potential abuse by requiring the expenditure of all current income within a short period after the close of the year. That provision was rejected by the Senate Committee as being too inflexible, thus, defeating the proper purpose of many exempt funds. Senate Report No. 2375, Aug. 22, 1950, U.S. Code and Cong. Serv. p. 3087. It was the joint conference which formulated Section 3814 as it was enacted.

The cases are more helpful in defining "unreasonable accumulations" in that they provide some standard by way of fact comparisons. The only case directly concerned with the construction of the wording of Section 3814(1) which has been reviewed by an appellate court is *Erie Endowment* v. *United States* (W.D. Pa. 1961), 202 F. Supp. 580, affirmed March 28, 1963, (C.C.A. 3) 316 F. 2d 151, where the cor-

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[2] There is no suggestion in the pleadings or evidence that there was any misuse of Foundation funds.

responding section of the 1954 Code was involved. In the *Erie Endowment* case, the clearly defined use for the major part of the current income was to accumulate $10,000,000.00, after which some worthwhile endeavor would be supported. The appellate court stated, page 155:

> " . . . The standard to be applied is whether the taxpayer can justify the total accumulation of income at the end of the taxable year, in terms of both time and amount, on the basis of a rational total program of charitable intent . . . "
>
> "Absent a justifiable total program of accumulation, however, tax exemption must be denied. The program must be prospective and not occur to the organization only after the Commissioner's shadow becomes visible. 'Afterthoughts will not suffice'."

The Court quoted *Stevens Bros. Foundation, Inc.* v. *C. I. R.* (1962) 39 T.C. No. 11, where the tax court found that accumulations of income were unreasonable as to time and amount. In the *Stevens* case, as in *Erie Endowment,* the record was barren of any particular use to which either the current income or the accumulated income would be put. The petitioner in the *Stevens* case had embarked on a student loan program but no attempt was made to relate needs to the money goal.

Both of the above cited cases distinguish the facts involved from the facts of *Samuel Friedland Foundation* v. *United States* (1956 N.J.), 144 F. Supp. 74, while quoting with approval the test suggested therein, page 92:

> "Does the organization have a concrete program for the accumulation of income which will be devoted to a charitable purpose and in the light of existing circumstances is the program a reasonable one?"

The Friedland Foundation's principle objective was charitable support for medical work and research and its particular primary objective during the years questioned was

to provide for the construction of a medical research building at Brandeis University. The Court considered four broad factors: (1) the purpose of the accumulation and the dollar goal, (2) the funds available at the beginning of the period, (3) the likelihood of funds becoming available from contributions, and (4) the extent of time required to reach the goal. The Court concluded that the accumulation over the years of the $500,000.00 committed to the construction of the building, which could, under existing circumstances, reasonably be accomplished in six to eight years was not unreasonable.

In three of the other cases turning upon a comparison of the facts with the statute, the yard stick of the income accumulations was the cost of or indebtedness on property. In *A. Shiffman* v. *C. I. R.*, 32 T.C. 1073, and in *Tell Foundation* v. *Wood*, 52 A.F.T.R. 1801, the income was used to pay off indebtedness on property which comprised assets of the foundations. In *Hulman Foundation* v. *United States*, 10 A.F.T.R. 2d 5374, the primary objective was to construct and maintain a civic building. The foundation had explored costs and sites, and before the end of the questioned period had determined that more money was needed than was available. In each case the Court found in favor of the foundation.

In *Truscott* v. *United States*, 1 A.F.T.R. 2d 1738, the Holloway Foundation sought to create a fund for retirement benefits of employees of an unrelated private company. Benefits payable at the time of the accumulation would amount to approximately $15.00 per employee per month and growth could not be anticipated to provide a substantial benefit for some years to come.

The distinctions between the facts of the instant case and the cited cases are more numerous than the similarities. In the two cases decided in favor of the Government, virtually no current program or purpose existed but to accumulate income for the sake of accumulation. On the other hand, the cases determined in favor of the foundations involved situations where the charitable program was specific and concrete. By the very nature of the programs, the money goal could be figured in rather specific dollar amounts and the time to achieve the goal, barring wide fluctuations from existing circumstances, could be narrowly calculated. The facts presented here are not easily aligned with either.

The Danforth Foundation showed, from the beginning, constant but uneven growth. The annual income spurted from $5,391.78 for 1928 to $43,952.62 for 1936, and to $197,638.75 for 1939. By the end of 1939 the Foundation had assets valued at $2,457,268.74. From 1944 through 1952, the assets, income and expenditures were as follows:

Year	Fair Market Value of Assets at Years End	Gross Income less Capital Gain	Charitable Gifts, Grants and Expenses	Administrative Expenses	Accumulation of Income less Capital Gain
1944	$ 4,425,190.90	$ 313,378.85	$ 73,984.49	$11,804.81	$1,574,758.09
1945	$ 7,444,197.79	$ 307,574.19	$ 94,152.98	$10,465.28	$1,777,714.02
1946	$ 7,279,645.72	$ 357,043.13	$164,244.96*	$25,340.45	$1,945,171.74
1947	$ 8,963,954.23	$ 531,135.91	$ 80,467.53	$20,325.85	$2,375,514.27
1948	$ 8,719,409.71	$ 592,579.18	$119,490.60	$24,042.70	$2,824,560.15
1949	$15,779,885.62	$ 819,321.95	$118,204.06	$21,933.02	$3,503,745.02
1950	$24,138,717.81	$ 955,719.44	$120,908.07	$26,867.15	$4,311,689.24
1951	$34,503,807.33	$1,290,241.45	$128,284.84	$56,965.63	$5,416,680.22
1952	$33,510,053.76	$1,221,295.12	$176,131.03	$67,104.85	$6,394,739.46

* Includes $125,000.00 pledged for construction of chapels over period from 1947-1956.

The scope of the activities sponsored and supported by the Foundation widened through the years.[3] Two programs, the Camp Miniwanca Program and the Youth Development Program, were started in the thirties and were carried through all the years in evidence. The Camp Miniwanca Scholarship program was a leadership training program where a number of young people were sponsored to attend camp at which emphasis was placed on religious and spiritual values. The total scholarships for this program varied from year to year but in the years 1949, 1950 and 1951, totaled $20,375.18, $6,882.00 and $22,640.00, respectively. Through the Youth Development Program, the Foundation sought to distribute to potential leaders among young people the inspirational book entitled, "I Dare You". The expenditures for this program fluctuated widely,—from several thousand dollars to almost $20,000.00.

About 1941, when Dr. William Hutchins, retired president of Berea College, came with the Foundation, additional programs were inaugurated which became regularly sponsored and supported programs of the Foundation. The first was the Danforth Associate Program whereby the Founda-

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EXPENDITURES ON FUNCTIONING PROGRAMS

Program	Grants or Charitable Expenditures		
	1950	1951	1952
Camp Miniwanca	$ 6,882.00	$22,640.00	$20,424.20
Youth Development	$ 8,235.11	$10,685.56	$11,421.78
Danforth Associates	$48,413.45	$39,151.74	$51,785.61
Danny Grads	$27,123.80	$33,531.21	$36,454.84
Danforth Summer Seminars			$17,652.50
Danforth Graduate Fellowships			$30,214.25
West Liberty State College—Dept. of Religion		$ 1,000.00	$ 2,000.00
Chapels	$15,000.00	$14,370.28	$11,151.64

tion provided selected college teachers, believed to hold high religious and spiritual values, with funds to aid in attaining informal contact with students outside the classroom. The grants of this program steadily increased through the years to $48,413.45 in 1950. The other program inaugurated by Dr. Hutchins became known by the title "Danny Grads". Selected women graduates were given leadership training and assigned for a year term to various college campuses to work with established religious organizations. The Danny Grads were given stipends from Foundation funds. Expenditures for this program increased to $27,123.80 in 1950.

Between the years 1947 and 1956, $125,000.00 was pledged toward the erection of college chapels. Approximately $56,000.00 of that amount was expended by the end of 1950.

In addition, throughout the years preceding the years involved in this case, the Foundation engaged in other charitable endeavors which did not become regular programs or which constituted a minor portion of its expenditures. These items included special study grants, prize awards and cancellations of college loans. The Foundation also undertook to support causes related to its purposes which were developed and operated by other exempt organizations, most often colleges or universities.

In about 1945 the trustees began looking for a full time director of the Foundation. Through Foundation activities, William Danforth had become acquainted with Dr. Kenneth Brown, then president of Denison College, and actively sought to engage him as director. Because of previous commitments to Denison, Dr. Brown delayed a decision

until about 1949 when he accepted the formal offer of the trustees to come with the Foundation and assume directorship January 1, 1951.

Dr. Brown had, before his association with the Foundation, been keenly interested in fostering the influence of Christian thought in secondary school teaching. He immediately, in February, 1951, pursued this interest by offering for consideration of the trustees a plan whereby Danforth Associates would be given scholarships to attend a special summer session designed to better acquaint them with the Christian religion, philosophy of religion, and practical applications of ethics and religious thought to teacher-student relationships. The first such seminar was planned for the summer of 1952 at an anticipated cost of about $25,000.00.

Plans were also under way early in 1951 to establish the Danforth Fellowship Program for the purpose of aiding potential college teachers of high caliber to attain graduate degrees. In September, 1951, letters were sent out to 900 accredited colleges for appointment of liaison officers to aid in selecting applicants. During thee winter applications were reviewed and approximately 140 applicants interviewed, and 40 or 50 persons selected.

Fellowships were granted on a proposed budget of $75,000.00 for the first year. Each fellowship was a commitment for continued grants for at least three years.

During the year 1951, the Foundation committed itself to provide one-half the salary, or $2,000.00, for a professor of religion at West Liberty College for a period of three

years while the department was being established. A similar commitment was made at a number of other colleges in subsequent years.

In the early part of 1952, pursuant to recommendations of leaders of the American Association of Colleges for Teacher Education, a summer conference was called to explore needs of the teacher college in the field of emphasizing spiritual and religious values. Out of that conference a program was derived for experimental purposes. A number of schools were chosen to experiment in the introduction, beginning in 1953, of emphasis on spiritual and religious values in some of the teaching courses. The plan anticipated annual cost of $30,000.00 for a five year period.

There were a number of other programs conceived by Dr. Brown or suggested to him which were briefly summarized in a memo to the trustees dated October 15, 1952, under the title "Possible New Activities". Some of these suggestions were in fact adopted in modified forms into Foundation programs in later years while others were discarded. There is no evidence that these additional programs were more than mere ideas during the years 1951 and 1952.

Based upon past expenditures and planned future expenditures revealed by the evidence, an objective sketch as of the end of the years 1951 and 1952 would be as follows:

	1951	1952	Projected for 1953
Accumulated Income At Years' Beginning	$4,311,689.24	$5,416,680.22	$6,394,739.46
Current Gross Income (less Capital Gain)	$1,290,241.46	$1,221,295.12	$1,000,000.00**
Charitable Expenditures for Programs	$ 121,378.79	$ 131,104.82	$ 325,000.00***
Estimate For Non - Program Expenditures	$ 30,000.00*	$ 30,000.00*	$ 50,000.00*
Administrative Expenditures	$ 56,965.63	$ 67,104.85	$ 70,000.00*
Excess of Income (less Capital Gains) Over Expenditures	$1,104,990.98	$ 978,059.24	$ 555,000.00

* Estimated by rounding off previous high.

** Estimate based upon downward trend.

*** Includes programs planned in 1952 to begin in 1953 or later and two year budget for Danforth Graduate Fellowship program.

Further projection would require the addition of costs for a third class of Graduate Fellows (originally budgeted at $75,000.00 per class per year) and recognize that virtually all of the programs have indicated a growing trend.

There can be no doubt that the trustees' decisions to accumulate income were made in good faith and in anticipation of early formulation of expansive programs which they believed would more than use the accumulated funds. In the spring of 1951, Donald Danforth and Dorothy Compton were so convinced of the Foundation's future monetary needs to carry out its plans in the years to come that they requested their father to change his will to leave their shares of his estate, which would have totaled $7,249,440.00, to the Foundation. However, it is not the subjective beliefs and aspirations of the trustees which will define reasonableness under the statute.

The Foundation relies heavily, in justification of its accumulations, on the fact that it had been trying for about five years prior to the years subject to Section 3814 to engage Dr. Brown as its director, and knew that once a director of Dr. Brown's caliber was employed, programs would eventually be developed that would use the funds. This argument is augmented by the fact that the years involved in this case were the first two years in which accumulations were restricted by the law. To allow these facts to qualify as justification would contradict the general intent and effect of the statute. It would allow continued accumulation without any plans for charitable expenditure other than the general purpose stated in the trust-forming instrument as long as there was some activity directed toward reaching a program-planning stage of development. The distinction is too narrow between that activity and an accumulation, as in *Erie Endowment,* merely to acquire assets capable of producing sufficient income to carry out charitable objectives in the future.

The Government argues at length that the purpose of Section 101(6) exemption is to give relief to organizations which serve the public in a capacity which relieves the public treasury. Thus, where current income is not paid out during each year, the reason for the exemption is not being served. The Court, as did Congress, recognizes that foundations may serve to lighten the demands on the public treasury in less direct but equally worthwhile ways than is contemplated by the governments argument. The 8th Circuit Court of Appeals in *Duffy* v. *Birmingham,* 190 Fed. 2d 738, as related here, distinguished organizations which are exempt under 101(6) from those not exempt by whether or not they served community interests or were primarily operated for the benefit of private parties. The Danforth Foundation, while it may not be a religious organization within the meaning of related statutes, bears a resemblance to exempt religious organizations in its

ultimate goals. Both are concerned with fostering ideas, philosophy and attitudes which are more or less universally believed to enrich individuals and, indirectly, the community. Because the Foundation's goals cannot be monetarily defined, and because its means must necessarily be through individuals effectively witnessing ethical, religious and spiritual values, it cannot be held to as strict a test of reasonableness in accumulation for programming as a foundation dedicated to acquiring or constructing a building.

Nevertheless, the evidence presented fails to show that the programs adopted will, as budgeted, begin to use expected annual income, let alone that accumulated before the questioned period. Furthermore, the record is absent any showing of attempt to relate the programs to anticipated income. Expenditures for programs designed by the end of 1951 could not be expected to exceed $300,000.00 in charitable grants, and under all programs designed by the end of 1952, expenditures could not be expected to exceed $500,000.00 in the immediate future. Further projection of probable charitable grants under programs of the Foundation would require speculation. Meanwhile, subsequent annual income could reasonably be anticipated to exceed $1,000,000.00. The conclusion that the unexpended income of $1,104,990.98 in 1951 and $978,059.24 in 1952, making a total accumulation of $6,394,739.46 by the end of 1952, constitute unreasonable accumulations is inescapable. Therefore, the Court finds in favor of the defendant on Counts I and II.

The Court adopts the foregoing as its findings of fact and conclusions of law. Entry of judgment will be delayed until trial of Counts V and VI, and further order of the Court.

Dated this 27th day of June, 1963.

/s/ *John K. Regan,*
U. S. District Judge.

APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 17,796.

The Danforth Foundation, Appellant, v. United States of America, Appellee.	Appeal from the United States District Court for the Eastern District of Missouri.

[June 30 1965.]

Before VAN OOSTERHOUT and MATTHES, Circuit Judges, and YOUNG, District Judge.

VAN OOSTERHOUT, Circuit Judge.

The issue presented by this appeal is whether the District Court rightly determined that the Commissioner properly denied taxpayer Danforth Foundation exemption from income tax for the years 1951 and 1952 upon the ground that taxpayer had unreasonably accumulated income in such years within the meaning of § 3814(1) of the Internal Revenue Code of 1939 as amended.

The factual background is fully and fairly set out in Judge Regan's well-considered memorandum opinion reported at 222 F.Supp. 761. We will not attempt to cover in detail the facts so well-stated and summarized in such opinion.

Taxpayer in the present action sought to recover income tax, interest and penalties assessed against it and paid by it, as follows:

		Section 291(a)	
Year	*Tax*	*Penalty*	*Interest*
1951	$187,785.79	$46,946.45	$94,542.00
1952	134,952.31	33,738.08	59,844.88

The penalty issue has been compromised and settled and is not before us. Taxpayer has abandoned the issue raised in the trial court that the Commissioner failed to allow him certain deductible expenses.

Taxpayer has paid the additional income assessed for 1951 and 1952. It filed claim for refund which was denied. This action was timely commenced to recover the 1951 and 1952 taxes and interest. The trial court upheld the Commissioner's determination that the income tax exemption had been lost because of unreasonable accumulation of income. The court dismissed the taxpayer's suit. This timely appeal was taken; this court has jurisdiction. 28 U.S.C.A. § 1291.

Taxpayer is incorporated under the laws of Missouri as a perpetual charitable foundation. With respect to purposes, its Articles as amended provide:

> "This Foundation is formed solely and only for purely charitable, educational and religious purposes and to promote the well-being of mankind throughout the United States."

The Commissioner by letter dated April 13, 1939, determined that taxpayer foundation was exempt from income tax under the provisions of § 101(6) I.R.C. 1939 for the year 1939 and "subsequent years so long as there is no change in your organization, your purposes or your method of operation."

On July 21, 1958, the Commissioner by letter advised taxpayer that he had after a careful review determined that the accumulation of income for the years 1951 and 1952 was unreasonable within the meaning of § 3814 and that his ruling reflected by his letter of April 13, 1939, is modified to the extent of disallowing exemption from income tax for the years 1951 and 1952. The letter notes that upon the basis of information furnished, the taxpayer is entitled to exemption from income taxation for 1953 and subsequent years and that contributions, bequests and gifts to the Foundation for all years remain deductible by the donors under §§ 170, 2055, 2106 and 2522, I.R.C. 1954 (and corresponding sections of I.R.C. 1939).

Thus, it is entirely clear that the fundamental charitable, religious and educational objectives of the Foundation have not been challenged or questioned and that the revocation of the income tax exemption applicable only as to the years 1951 and 1952 was based entirely upon the unreasonable accumulation of income during such years.

Section 3814, the controlling statute on the issue before us, was enacted effective September 23, 1950, (§ 331 Rev. Act of 1950, 64 Stat. 957, 958) and was made applicable to taxable years commencing after December 31, 1950. § 333 Rev. Act of 1950. Taxpayer operated on a calendar year basis. Hence § 3814 applies to the taxpayer for 1951 and 1952 and subsequent years.

Section 3814 provides that the income tax exemption of otherwise exempt charitable organizations shall be denied for any taxable year—

> "* * * if the amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year—

> (1) are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under Section 101(6); * * *"

Section 3814 also denied tax exemption for other reasons not applicable here. No issue is here raised as to any misuse of the foundation except with respect to the income accumulation.

Prior to the 1950 enactment of § 3814, there was in existence no prohibition, statutory or otherwise, of income accumulation by a bona fide charitable foundation such as the taxpayer. We agree with the taxpayer's contention that the reasonableness of income accumulations prior to 1951 is not directly here involved. However, the amount of prior accumulations along with other accumulations, such as the totals of assets on hand, the program and needs of the foundation, is entitled to consideration in determining the reasonableness of the accumulations in 1951 and 1952. In reply to a similar contention made in *Stevens Bros. Foundation, Inc.* v. *Commissioner,* 8 Cir., 324 F.2d 633, 640, we said:

> "Neither are we impressed with Foundation's argument that the Tax Court improperly considered accumulations prior to the enactment of the unreasonable accumulations statute in 1950. As demonstrated, this Act operated prospectively to deny tax exempt status. However, it is clear from the wording of the statute that accumulations of the taxable year and preceding years are to be *considered* in resolving the question whether the accumulations were unreasonable. See *Erie Endowment* v. *United States, supra,* 316 F.2d at 156, fn. 20."

Taxpayer relies upon the legislative history of § 3814 to support its position that substantial discretion was left with charitable organizations with respect to the accumulation of income consistent with trust purposes. Attention is called to the fact that the bill as originally passed by the House required, subject to a few exceptions, the expenditure of all current income for trust purposes. The Senate rejected such provision as being too inflexible. The present statute arose out of the conference report. In considering the statute in the light of the legislative history, the Third Circuit in *Erie Endowment* v. *United States,* 3 Cir., 316 F.2d 151, 153, states:

> "Here, an express if imprecise limitation against unreasonable accumulations has been written into the law. Senator George, Chairman of the Senate Finance Committee, presenting the Conference Report to the Senate, declared that the purpose of the provision was 'to force * * * charitable organizations to spend currently the money which they receive for the purposes upon which their favored tax status is based.' . . . Absent a sufficient amount of charitable work commensurate with the total amount of Erie's available charitable funds, exempt status must cease or, in fact, never come into existence."

It is clear from the language of the statute itself that Congress intended to tax accumulated income of charitable foundations which is unreasonable in amount or duration.

Treasury Regulations 111, § 29.3814-1 as amended provide inter alia:

> "Amounts accumulated out of income become unreasonable when more income is accumulated than is needed, or when the duration of the accumulation is longer than is needed, in order to carry out the pur-

pose constituting the basis for the organization's exemption.

* * *

"Whether the conditions specified in paragraphs (1), (2) and (3) of section 3814 are present in any case must be determined from all the facts."

In *Stevens Bros. Foundation, supra,* in considering the standards to be applied in resolving the unreasonable accumulation issue, we quoted and applied the test stated in *Samuel Friedland Foundation* v. *United States,* D. N.J., 144 F.Supp. 74, 92, reading:

" 'What the true test appears to be is this,—Does the charitable organization have a concrete program for the accumulation of income which will be devoted to a charitable purpose and in the light of existing circumstances is the program a reasonable one?' " 324 F.2d 633, 639.

We likewise quoted with approval from *Erie Endowment, supra,* including the following excerpt:

" ' "Reasonableness," that hobglobin of judicial minds, can only be divined on the basis of all relevant facts. The standard to be applied is whether the taxpayer can justify the total accumulation of income at the end of the taxable year, in terms of both time and amount, on the basis of a rational total program of charitable intent. The plan must be viewed in its entirety.' " 324 F.2d 633, 640.

In applying the law gathered from the quoted authorities to the facts of the case, we said:

"However, these loans and grants were not made as the result of any formulated or definite plan and such aid was not geared to the amount of Foundation's income. In the absence of a concrete program no reasonable justification appears for the large accumulations for the years in question." 324 F.2d 633, 640.

Stevens involved issues concerning abuses not present in the case before us. However, we were in *Stevens* confronted with the interpretation of the unreasonable accumulation provision of § 3814. We adhere to the interpretation of the statute there made.

There can be no question upon the record before us as to the utmost good faith and the humanitarian and charitable purposes of William H. Danforth, creator of the trust, and William H. Danforth, his son Donald Danforth and his daughter, Dorothy Compton, who were serving as trustees of the Foundation during the period here in controversy. We fully agree with the trial court's finding, reading:

> "There can be no doubt that the trustees' decisions to accumulate income were made in good faith and in anticipation of early formulation of expansive programs which they believed would more than use the accumulated funds. In the spring of 1951, Donald Danforth and Dorothy Compton were so convinced of the Foundation's future monetary needs to carry out its plans in the years to come that they requested their father to change his will to leave their shares of his estate, which would have totaled $7,249,440.00, to the Foundation. However, it is not the subjective beliefs and aspirations of the trustees which will define reasonableness under the statute." 222 F.Supp. 761, 767.

It is established that the trustees were willing and anxious at all times to have the trust funds applied for the fulfillment of the objectives of the trust. Under the trust agreement, principal as well as interest could be used for trust purposes. Donald Danforth testified that the trustees were willing to invade the corpus and that the trustees had no desire to restrict disbursements in

order to perpetuate the trust. Dr. Brown testified that while he was serving as executive director no limitation with respect to cost of acceptable programs was placed upon him.

The Foundation received substantially all of its assets in the form of gifts from William H. Danforth and his wife. Mr. Danforth was the driving force and genius behind the creation and growth of Ralston Purina Co. The initial gift of assets valued at $101,030 was made in 1927. Additional gifts were made at frequent intervals thereafter. Most of the gifts were in the form of stock of Ralston Purina Co. The value of this stock has appreciated tremendously. At the close of the year 1950, a net market value of the Foundation's assets was $24,138,717 and its accumulated income, less capital gains, was $4,311,689. For the years 1951 and 1952, its gross income less capital gains amounted to $1,290,241 and $1,221,295 respectively. Its charitable expenditures for 1951 amounted to $128,284 or about 10% of its income. For 1952, the charitable expenditures were $176,131 or less than 15% of income. During the two year period the accumulated income was increased by over $2,000,000 to $6,934,739 at the end of 1952. A table summarizing pertinent financial information for the years 1944 through 1952 appears at p. 765 of 222 F.Supp. By 1960 the market value of trust assets had increased to $98,839,088. The income for that year was $2,787,817, while charitable expenditures amounted to $3,105,006. The accumulated income at the end of 1960 was $4,727,264.

It is entirely clear that the Foundation had very substantial accumulations out of income during the years 1951 and 1952. Taxpayer does not question this. The attack is upon the court's finding that the accumulations for such years were not reasonable. Taxpayer in support

of its contention that the 1951 and 1952 income accumulations were reasonable urges that the Foundation's primary purpose has always been to promote moral, spiritual and religious values in education through self-inspired and self-operated programs as distinguished from bare monetary grants to existing charitable or educational institutions. As demonstrated by the trial court in its opinion, some programs had been conceived and carried out. The total of all charitable contributions made by the Foundation including non-program grants from the inception of the trust in 1927 through 1952 amounted to approximately $1,400,000. By 1945, it became apparent to the trustees that considerably more money was available than needed for carrying out the existing self-operated programs. A diligent search was instituted for a competent executive director who was in sympathy with the objectives of the Foundation. One of his principal duties would be to devise self-operated programs for carrying out the objectives of the trust. Such a man was found in Dr. Brown, then President of Denison University. After extensive negotiations, Dr. Brown accepted employment as executive director in October 1949 but due to prior commitments he was unable to enter upon active duty until January 1, 1951. Dr. Brown entered into the performance of his work with skill and diligence. He submitted a number of new programs for utilizing the trust funds which were adopted and placed in operation. With respect to the plans adopted in 1951 and 1952, the court found:

> "[T]he evidence presented fails to show that the programs adopted will, as budgeted, begin to use expected annual income, let alone that accumulated before the questioned period. Furthermore, the record is absent any showing of attempt to relate the pro-

grams to anticipated income. Expenditures for programs designed by the end of 1951 could not be expected to exceed $300,000.00 in charitable grants, and under all programs designed by the end of 1952, expenditures could not be expected to exceed $500,000.00 in the immediate future. Further projection of probable charitable grants under programs of the Foundation would require speculation. Meanwhile, subsequent annual income could reasonably be anticipated to exceed $1,000,000.00. The conclusion that the unexpended income of $1,104,990.98 in 1951 and $978,059.24 in 1952 making a total accumulation of $6,394,739.46 by the end of 1952, constitute unreasonable accumulations is inescapable." 222 F.Supp. 761, 768.

Additionally, taxpayer asserts that a number of other programs were conceived by Dr. Brown which were summarized by him in a memorandum to the trustees dated October 15, 1952, under the title "Possible New Activities". With respect to such programs, the court properly found: "There is no evidence that these additional programs were more than mere ideas during the years 1951 and 1952." 222 F.Supp. 761, 767.

We fully agree that Dr. Brown's suggestions contained in his October 1952 memorandum had not reached the status of a concrete program. Moreover, the evidence indicates that during the ten years Dr. Brown served the program expenditures never came close to approaching annual gross income.

The trustees, after learning in 1953 that the income tax-exemption was being questioned by reason of income accumulations, rapidly increased the Foundation's non-program grants to qualified beneficiaries and thus made sufficient use of its income to entitle it to tax exemption for 1953 and subsequent years. Thus, it is apparent that it

is possible for a foundation to comply with the unreasonable income accumulation provision of § 3814 within a reasonably short time. Here it is obvious that it would have taken the Foundation many years to devise well-conceived, self-operated programs which would consume its substantial and growing annual income.

It would defeat the language and intent of § 3814, which was designed to force the use of foundation income for charitable purposes, to permit the delay in distribution of accumulating income which would result from withholding disbursement of such income until adequate self-operating programs were established which would consume the income as it accumulated. The trust by 1951 was a well-established trust. The problem of a large excess of income over charitable expenditures was not a new one. The burden imposed upon the taxpayer here by § 3814 was in essence the same as that imposed upon other foundations.

The trial court's opinion reflects that it gave full consideration to all sources of aid in the interpretation problem presented to it and that it reached an interpretation of the statute in accord with that reached by this court in *Stevens*. The findings of fact made by the trial court that the 1951 and 1952 accumulations of income by the trust are unreasonable is not induced by any erroneous view of the law and is adequately supported by substantial evidence.

The order dismissing the taxpayer's complaint is affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.